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**UNITED STATES BANKRUPTCY COURT**  
**NORTHERN DISTRICT OF CALIFORNIA**

In re	)	No.	01-30923 DM
PACIFIC GAS & ELECTRIC COMPANY,	)	Chapter	11
Debtor.	)	Date:	June 18, 2001
	)	Time:	10:00 a.m.
	)	Ct:	Hon. Dennis Montali
	)		235 Pine Street, 22 <sup>nd</sup> Floor
	)		
	)		

**UNITED STATES TRUSTEE'S**  
**OPPOSITION TO MOTION FOR ORDER AUTHORIZING**  
**ESTABLISHMENT OF MANAGEMENT RETENTION PROGRAM**

Linda Ekstrom Stanley, United States Trustee, opposes the motion of Pacific Gas and Electric Company ("PG&E") for an order authorizing the creation of a Management Retention Program. PG&E seeks to confer as much as \$17.5 million in bonuses on its upper level management. The request is not supported by case law and not appropriate given the facts of this case and should be denied.

There seems little doubt PG&E will emerge intact from bankruptcy. Unlike many companies in bankruptcy which are nothing more than a collection of assets to be preserved and then sold to pay claims, PG&E is a company with a future, a company that counts among its customers nearly half of the population of the state of California. Indeed,

1 PG&E has repeatedly promised to pay all claims in full and its assets *at book value* exceed  
2 its liabilities by at least \$17.7 *billion*. PG&E does not allege it has suffered an exodus of  
3 employees jeopardizing its assets or the functioning of its systems. PG&E does not allege  
4 its employees are leaving in droves because they know their jobs will be terminated.

5 PG&E has not made a proper showing its managers have any intention, let alone  
6 incentive, to leave the company now. The contrary is probably true. Many of PG&E's  
7 managers undoubtedly have compensation and retirement packages which are dependent  
8 on continued employment with the company and it is difficult to imagine they would willingly  
9 leave these packages behind.

10 Most important, there seems little benefit to the estate in the Management Retention  
11 Program. The vast majority of the bonuses will be paid to the company's managers  
12 regardless of whether PG&E's as yet-unfiled plan is confirmed or not. The Management  
13 Retention Plan is just a pay raise for hard work, a burden many parties to this case share  
14 without any incentive or retention payments at all.

## 15 I. ARGUMENT

### 16 A. The Cases PG&E Cites in Support of the Retention Motion Are Factually 17 Distinguishable

18 PG&E relies principally on two cases for the proposition it is appropriate for the  
19 bankruptcy court to approve the Management Retention Plan. The facts of those cases are  
20 completely different from PG&E's case and the decisions do not support granting PG&E's  
21 motion. Close examination reveals the decisions compel the conclusion no retention  
22 program should be approved.

23 The first case PG&E cites is *Dai-Ichi Kangyo Bank Ltd. v. Montgomery Ward Holding*  
24 *Corp. (In re Montgomery Ward Holding Corp.)*, 242 B.R. 147 (D. Del. 1999). In Montgomery  
25 Ward, a nation-wide retailer under severe financial distress sought bankruptcy protection.  
26 After filing, the company experienced a dramatic increase in employee turnover. The  
27 company's expert attributed the high turnover to an extensive recruiting and solicitation  
28 campaign created and run by the company's competitors. The court, in granting the motion

1 to implement a retention program, held the company was “under siege” and in need of  
2 protection to ensure a successful reorganization.

3 In *In re America West Airlines, Inc.*, 171 B.R. 674 (Bankr. D. Ariz. 1994), the debtor,  
4 a regional airline, sought approval of a bonus plan for employees after the company had  
5 successfully reorganized over a three year period. In addition to rewarding key officers and  
6 managers, the debtor was authorized to reward the rank and file employees in appreciation  
7 of and consideration for their service while enduring downsizing, wage cuts, and salary  
8 freezes.

9 Neither of these cases supports approval of the Management Retention Plan:

10 1. PG&E Has Provided No Evidence PG&E’s Management Team is at  
11 Risk of Being Lured Away by Competitors

12 In Montgomery Ward, the company’s expert testified convincingly that following  
13 Montgomery Ward’s bankruptcy filing, its competitors launched a massive recruitment and  
14 solicitation campaign, resulting in a 50% increase in management turnover and a 33%  
15 increase for wage level employees. *In re Montgomery Ward Holding Corp.* 242 B.R. at 150.  
16 There is no evidence PG&E’s management is being lured away.

17 2. PG&E’s Plan is Not Conditioned on Success in Chapter 11

18 The bankruptcy court in *America West* only granted approval of the debtor’s incentive  
19 plan after being convinced of debtor’s employees’ hard work and supreme effort during  
20 chapter 11, and after seeing the result of that work, the successful reorganization of an  
21 airline. *In re America West Airlines, Inc.*, 171 B.R. at 676. Except with respect to a few  
22 senior managers, PG&E’s Management Retention Plan does not make success in chapter  
23 11 a requirement for payment of the bonuses. Indeed, if the company is in chapter 11 two  
24 years from now, the bonuses will still be paid. To the extent these bonuses are attributable  
25 largely to long term longevity, they should not be granted.

26 3. PG&E Has No Apparent Intention of Liquidating; There is No Proof  
27 Jobs are In Jeopardy Nor That Large Numbers of Employees are  
28 Leaving

Retention programs are often created to preserve management talent while assets

are sold. An incentive scheme is often justified in such cases to preserve asset value by ensuring the services of employees with know-how to operate a company while the remaining workforce shrinks. *In re Montgomery Ward Holding Corp.* 242 B.R. at 150. There is no concern in this case the company will not survive chapter 11 and there is no proof employees are deserting the company. Given the circumstances, the bonuses should not be approved.

4. Bonuses to PG&E's Management Team Will Not Necessarily Improve Its Chances of Successful Reorganization

In *Montgomery Ward*, the court concluded the incentive plan was necessary to increase the company's chances for success in chapter 11. The court cited the need to improve the public's perception and confidence in the retailer as an ingredient for a successful reorganization. *In re Montgomery Ward Holding Corp.* 242 B.R. at 152. The *Montgomery Ward* court's concern that customers would shop elsewhere and diminish the company's chances for survival if the debtor's operations became destabilized is of no concern here. Although PG&E's public perception may be unfavorable, its customers have no choice but to continue purchasing power from it, so there is no cognizable threat posed to the company by public "perceptions". PG&E's customers are captives.

5. Cash Payments Are Not the Only Means of Retaining Employees

There are many ways to provide retention incentives to employees. In *America West*, a significant portion of senior management's bonus consisted of restricted stock. Another good example is found in PG&E's Senior Executive Retention Program for "certain key officers," a copy of which is attached to Mr. Jackson's declaration in support of the motion as Exhibit 5 (and referred to in footnote 2 of that declaration). PG&E gives its senior executives restricted stock units in PG&E Corporation, its parent.

PG&E does not discuss or offer any alternative to the cash bonus structure proposed. Under the circumstances, PG&E has not shown the cash payments are necessary or prudent.

**B. PG&E's Plan Disproportionately Benefits Senior Management and Does not Pass the "Business Judgment" Test**

PG&E acknowledges it must satisfy the "business judgment " test generally applied to motions to use estate property outside the ordinary course of business under 11 U.S.C. § 363. See *In re Committee of Equity Sec. Holders v. Lionel Corp. (In re Lionel Corp.)*, 722 F.2d 1063, 1071 (2d Cir. 1983). PG&E's motion does not pass the business judgment test because it takes aim exclusively at PG&E's most senior employees without any express justification.

PG&E says its Management Retention Program will distribute \$17,500,000 among 226 management personnel with an average award of \$77,000. (Schedule A, Declaration of Russell M. Jackson). Although arithmetically correct, the proposed distribution of \$17,500,000 will be directed largely at PG&E's most senior management,

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as the chart below shows:

<b>Tier One - Senior Officers</b>	<b>Average Base Salary<sup>1/</sup></b>	<b>Proposed Retention Award</b>
Mr. Gordon Smith	\$630,000	\$ 630,000
Two Senior Officers	\$307,530	615,060
Three Senior Officers	260,040	780,120
Total, Tier One Retention Awards (Retention Award = 100% of Base Salary)		\$ 2,025,180

<b>Tier Two - Officers</b>	<b>Average Base Salary</b>	<b>Proposed Retention Award</b>
17 Senior Vice Presidents	\$182,360	\$3,100,140
Total, Tier Two Retention Awards (Retention Award = 100% of Base Salary)		\$3,100,140

<b>Tiers Three &amp; Four</b>	<b>Average Base Salary</b>	<b>Proposed Retention Award</b>
203 Managers/Attorneys	Information unavailable	\$12,374,680
Total, Tiers Three and Four Retention Awards (Tier 3 Retention Award = 50-75% of Base Salary) (Tier 4 Retention Award = 25-50% of Base Salary)		\$12,374,680

PG&E's plan is focused on the company's top management. This is the same team that decided to implement the Management Retention Plan. PG&E's Management Retention Plan's focus on the company's senior management suggests those employees with the most to gain are the active proponents. The United States Trustee questions whether this decision was an appropriate exercise of management's business judgment.

PG&E's nearly exclusive focus on senior management is inconsistent with the bonus program approved in *America West*. In that case, America West sought permission to reward to its rank and file employees, awarding them a total of \$9.5 million. *In re America West Airlines, Inc.*, 171 B.R. at 676. America West's bonus structure was intended to

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<sup>1/</sup> Annual salary figures were extrapolated from PG&E's response to Statement 23 in the Statement of Financial Affairs.

1 compensate its employees who had already endured three years of wage cuts and salary  
2 freezes. PG&E's plan benefits only the top 1% of its workforce and makes no allocation for  
3 rank and file employees. PG&E's employees have been paid in full since the case  
4 commenced and received special treatment – full payment – for their pre-petition wage  
5 claims.

6 **C. PG&E's Factual Record Is Insufficient to Merit the Relief Requested**

7 Even if PG&E's motion were consistent with case law on the subject, it should not be  
8 granted because the factual record is incomplete at best. PG&E relies exclusively on Mr.  
9 Jackson's declaration. In his declaration, Mr. Jackson says he is "informed and believes"  
10 the current situation "raises retention issues of a widespread nature," and that "essential  
11 employees would be difficult or impossible to replace." (6:11-16). He opines the proposed  
12 retention program is "in the best interests of PG&E and its estate." (7:2-3).

13 These statements do not support the relief requested. Mr. Jackson is not qualified as  
14 an expert in the declaration, so his opinion is of no value. Even if he were an expert, Mr.  
15 Jackson does not say what methods he used to arrive at this conclusion. For instance, did  
16 he survey the management team about its satisfaction with the present situation? Did he  
17 review comparable surveys of other companies to decide whether PG&E's employees were  
18 unusually likely to leave its employ? Did he evaluate what market tools, such as cash,  
19 deferred compensation, stock or options, would best accomplish retention of management?  
20 His remarks are general and assume the very conclusions he makes.

21 It is important to contrast PG&E's testimony with the testimony relied upon by the  
22 District Court of Delaware in *Montgomery Ward*. In that case, the company presented two  
23 experts on human resources who testified to the necessity of the company's retention  
24 program, the appropriateness of the program adopted for the company's needs, and the  
25 benefits the program would provide the debtor while it reorganized. *In re Montgomery Ward*  
26 *Holding Corp.*, 242 B.R. at 150.

27 Mr. Jackson's testimony should not be given great weight because it is conclusory  
28 and unsupported by market comparisons. There is no basis for granting the motion if one

1 accords Mr. Jackson's declaration the weight it deserves.

2 **II. CONCLUSION**

3 For the foregoing reasons, the motion to implement a Management Retention Plan  
4 should be denied.

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6 Date: June 11, 2001

Patricia A. Cutler  
Assistant United States Trustee

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9 By:

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Stephen L. Johnson  
Attorneys for United States Trustee